

DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS NUMBER: 02-0408
Income Tax
For the Years 1996- 2000

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ISSUES

I. Income Tax-Unrelated Business Income

The taxpayer protests the assessment of tax on certain income.

Authority: 26 IRC Sec. 513, IC 6-8.1-5-1 (b), IC 6-2.1-2-2, IC 6-3-8-1, IC 6-3-2-1, IC 6-2.1-3-20(a), IC 6-3-2-2.8, IC 6-3-8-5, IC 6-2.1-3-23 and IC 6-3-2-3.1, Black's Law Dictionary 213 (5th ed. 1979), Indiana Bell Telephone Co. v. Indiana Department of Revenue, 627 N.E. 2d 1386, Ind. Tax Court (1994), Raintree Friends Housing v. Indiana Department of Revenue, 667 N.E.2d 810 (Ind. Tax 1996).

II. Tax Administration-Penalty

The taxpayer protests the assessment of the ten per cent penalty.

Authority: IC 6-8.1-10-2.1, 45 IAC 15-11-2(b).

STATEMENT OF FACTS

The taxpayer is a not-for-profit corporation that operates a living museum with demonstrations and a recreation of a turn-of-the-century village and farmstead. The corporation also operates a hotel adjacent to and affiliated with the living museum. After an audit, the Indiana Department of Revenue, hereinafter referred to as the "department," assessed additional gross income tax, adjusted gross income tax, supplemental net income tax, interest and penalty. The taxpayer protested the assessment and a hearing was held.

I. Income Tax-Unrelated Business Income

DISCUSSION

The taxpayer considered all of its income exempt from gross income tax and adjusted gross income tax due to its not-for-profit status. The department assessed gross and adjusted gross income tax on the portion of the taxpayer's income considered unrelated to its not-for-profit purpose.

IC 6-2.1-2-2 imposes gross income tax on “. . . the entire taxable gross income of a taxpayer who is a resident or domiciliary of Indiana. . .” IC 6-3-2-1 imposes adjusted gross income tax on “. . . the adjusted gross income of every resident person, . . .” IC 6-3-8-1 imposes the supplemental net income tax on corporations. The taxpayer, as an Indiana corporation, is subject to these taxes unless a specific exemption is provided elsewhere in the law. All tax assessments are presumed to be accurate and the taxpayer bears the burden of proving that any assessment is incorrect. IC 6-8.1-5-1 (b). Further, it is established law that all tax exemptions must be strictly construed against taxpayers. Indiana Bell Telephone Co. v. Indiana Department of Revenue, 627 N.E. 2d 1386, Ind. Tax Court (1994).

IC 6-2.1-3-20(a) and IC 6-3-2-2.8 provide exemptions from the gross income tax and adjusted gross income tax for the income of a qualified not-for profit corporation derived from the corporation's activities promoting the corporation's charitable purpose. Pursuant to IC 6-3-8-5, the supplemental net income tax has the same exemptions as the adjusted gross income tax. The Indiana Tax Court dealt with these exemptions in the case Raintree Friends Housing v. Indiana Department of Revenue, 667 N.E.2d 810 (Ind. Tax 1996). In this case, the Court found that a housing corporation that provided retirement housing qualified for the charitable purposes exemptions from the gross income tax, adjusted gross income tax, and supplemental net income tax. Since the tax statute does not define the term “charitable,” the Court looked to the definition found in Black's Law Dictionary 213 (5th ed. 1979) as follows:

Charity is broadly defined as:

A gift for, or institution engaged in, public benevolent purposes. [It is a}n attempt in good faith, spiritually, physically, intellectually, socially and economically to advance and benefit mankind in general, or those in need of advancement and benefit in particular, without regard to their ability to supply that need from other sources and without hope or expectation, if not with positive abnegation, of gain or profit by donor or by instrumentality of charity.

The taxpayer does provide the benevolent service of educating people about a turn of the century Indiana farming village. Individuals learning about the history of Indiana benefits all of society. Further, the taxpayer does not gain personally from the provision of these educational services. The taxpayer's activities meet the definition of charitable as did the retirement center in the Raintree Case. Therefore, the taxpayer's income derived from activities directly involved in providing this beneficial and educational service qualify for the charitable purpose exemption.

Not-for-profit status as a charitable corporation, however, does not automatically qualify a corporation for the charitable purpose exemption on all income. The exemptions are limited by

IC 6-2.1-3-23 and IC 6-3-2-3.1 respectively that impose gross and adjusted gross income tax on a charitable not-for-profit's unrelated business income as defined in Section 513 of the Internal Revenue Code. The department's assessment of gross and adjusted gross income tax was guided by the provisions of 26 IRC Sec. 513 as follows:

. . . The term "unrelated trade or business" means, in the case of any organization subject to the tax imposed by section 511, any trade or business the conduct of which is not substantially related (aside from the need of such organization for income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption under section 501.

The department agreed with the taxpayer that the village income from general admission charges, blacksmithing, and special events is directly related to and furthers the historical and educational purpose of the taxpayer. The horse feed vending machine also furthers the taxpayer's charitable purpose in that the feeding of horses is an activity routinely engaged in during the turn of the century and it is beneficial and educational for visitors to engage in that historical experience. However, the department considered several of the activities and sources of income as unrelated to the primary charitable, educational purpose of the taxpayer and assessed gross income tax, adjusted gross income tax and supplemental net income tax on the proceeds from these activities. The taxed sources of revenue include income from refreshment stands, product sales in the general store, hotel revenues, product sales outside the general store but within the village and the penny machine. These activities are not substantially related to the taxpayer's educational purpose. Therefore, this income does not qualify for exemption.

FINDING

The taxpayer's protest to the tax assessed on the income from the horse feed machine is sustained. The remainder of the taxpayer's protest is denied.

II. Tax Administration-Penalty

DISCUSSION

The taxpayer also protests the imposition of the ten percent (10%) negligence penalty pursuant to IC 6-8.1-10-2.1. Negligence is defined at 45 IAC 15-11-2(b) as "the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer." Negligence is to "be determined on a case-by-case basis according to the facts and circumstances of each taxpayer." Id.

IC 6-8.1-10-2.1(d) allows the department to waive the penalty upon a showing that the failure to pay the deficiency was based on "reasonable cause and not due to willful neglect." Departmental regulation 45 IAC 15-11-2 (c) requires that in order to establish "reasonable cause," the taxpayer must demonstrate that it "exercised ordinary business care and prudence in carrying out or failing

to carry out a duty giving rise to the penalty imposed. . . “ The taxpayer presented substantial evidence showing that it met this burden. The negligence penalty does not apply in this situation.

FINDING

The taxpayer’s protest is sustained.

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